

ENERGY/RHG

Decision \_\_\_\_\_

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHWEST )  
 GAS CORPORATION U-905-G, for authority to: )  
 (i) issue one or more types of Debt Securities in the )  
 principal amount of up to \$550,000,000; )  
 (ii) refinance previously issued short-term debt )  
 securities; and (iii) enter into one or more interest )  
 rate risk management contracts. )  
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Application 01-08-012  
 (Filed August 10, 2001)

## **OPINION**

### **Summary**

This decision grants Southwest Gas Corporation (Southwest) the authority requested in Application (A.) 01-08-012 (Application).

Southwest requests authority, pursuant to Public Utilities (PU) Code §§ 816, 817, 818, 821, 822, 823, and 830 for the following:

1. to obtain debt capital in an aggregate principal amount of up to \$550,000,000 directly through the issuance and sale of debentures, notes, medium-term notes, bonds, loans, or other evidence of indebtedness which includes, without limitation, commercial paper programs, extendible commercial notes, banker's acceptances, or other short-term instruments (debt securities) which are or may become available in the capital markets or indirectly through governmental entities;
2. to refinance, refund, or replace its current level of short-term debt securities through the issuance and sale of authorized debt securities; and
3. to enter into one or more arrangements to manage interest rate risk associated with Southwest's outstanding and future debt, including without limitations, interest rate swaps, caps, floors, collars or similar interest rate management methods.

Notice of the filing of the Application appeared on the Commission's Daily Calendar of August 15, 2001. No protests have been received.

### **Background**

Southwest, a California corporation, is a public utility under the jurisdiction of this Commission, and is primarily engaged in the business of distributing and selling natural gas in certain portions of San Bernardino, El Dorado, Placer and Nevada Counties, California. Southwest is also engaged in the intrastate transmission, sale, and distribution of natural gas as a public utility in certain portions of the states of Nevada, and Arizona and is a "natural gas company," within the meaning of the Natural Gas Act, subject to the jurisdiction of the Federal Energy Regulatory Commission with respect to interstate transmission facilities and sales of natural gas for resale on its northern Nevada system.

For the 12 months ended March 31, 2001, Southwest had gas operating revenues of \$1,050,851,805 and net income of \$42,873,330. Southwest earned 59.5% of its gas operating revenues in Arizona, 11.88% in California, and 28.62% in Nevada.

### **Debt Securities**

Southwest seeks authorization to issue debt in an aggregate principal amount of up to \$550,000,000. The Application states that the precise amount and timing of each type of debt obligation; the market in and the method by which it will be issued; and the terms and provisions, price, and interest rate (which may be fixed adjustable, variable or set by auction, remarketing, or other rate setting procedures) will be determined by Southwest, with due regard for its financial condition and requirements then prevailing and anticipated market conditions, including competing demands for funds, existing at the time of sale.

Southwest proposes to issue any of the following debt securities, which are described in detail under Section 8.4, pages 7 to 9 of the Application:

1. Bonds or Debentures
2. Notes
3. Loans and Private Placement Indebtedness
4. Other Floating Rate Debt

The debt securities may be issued directly as debentures, notes, bonds, loans, or other evidences of indebtedness which may include, without limitation, commercial paper programs, extendible commercial notes, bank loans, private placement with insurance companies or other lenders, bankers' acceptances, or other variable rate or fixed rate borrowing instruments which are or may become available in the capital markets.

The debt securities may also be issued indirectly through one or more governmental agencies and loaned to Southwest, with such loans evidenced by entering into a financing agreement as described below. Each financing will be issued through the use of an indenture, bidding and offering document, purchase agreement, loan agreement, underwriting agreement, or other documents and instruments customary for the financing method selected by Southwest.

Southwest may have the opportunity to issue securities under the aegis of governmental agencies (Agency) by unconditionally guaranteeing or otherwise securing such Agency's obligations in respect to its issuance of tax-exempt debt in connection with the financing of Southwest's facilities. The utility anticipates using the tax-exempt option whenever its facilities qualify for tax-exempt financing under federal law and such financing is available on terms more favorable than those available for taxable financing. It is currently contemplated that such financing would require Southwest to enter into, concurrently with the sale and issuance of such securities, a loan agreement and/or a guarantee arrangement with the Agency regarding such securities.

Southwest states in the Application that other floating rate debt may include other short-term variable rate instruments. Pursuant to PU Code § 823(b), a public utility may issue notes, for proper purposes and not in violation of any provision of law, payable at periods of not more than 12 months after the date of issuance of the notes without the consent of the Commission. However, the Application also states that Southwest intends to use the proceeds from the issue of debt capital to refinance or exchange existing preferred securities and short- and long-term debt.

PU Code § 823(d) provides that no note payable at a period of not more than twelve months after the date of issuance of such note shall, in whole or in part, be refunded by any issue of stocks or stock certificates or other evidence of interest or ownership, or of bonds,

notes of any term or character, or any other evidence of indebtedness, without the consent of the Commission.

For purposes of this Application and pursuant to PU Code 823(d), we will permit Southwest to refinance, refund, or replace short-term debt with the authority granted in this decision.

### **Interest Rate Risk Management Contracts**

Southwest requests authority to enter into one or more contracts for the purpose of managing interest rate risk. Such contracts could take a number of forms including interest rate swap agreements, interest rate cap agreements, interest rate floor agreements, and interest rate collar agreements. Such contracts could also include hedging future fixed rate debt issuance such as Treasury locks, caps and collar agreements. A general description of the above are presented under Section 9.3, pages 10 to 12 of the Application.

Southwest has previously received Commission authority to enter into fixed- and floating-rate debt transactions (most recently under D.00-09-009 dated September 7, 2000).

Having previously stated the parameter whereby interest rate risk management contracts and other derivative financial instruments may be used, we will in this decision require the following conditions on Southwest's transactions pertaining to interest rate risk management:

1. Southwest should separately report all interest income and expense arising from all interest rate transactions in all monthly and annual financial reports to the Commission.
2. If Southwest elects to terminate an interest rate agreement before the original maturity or the other party terminates the agreement, all costs associated with the termination should be subject to review in Southwest's cost of capital proceeding.
3. Swaps and other derivative financial instruments carrying potential counterparty risk which Southwest received in connection with long-term debt must have counterparties with credit ratings equal to or better than Southwest's.

4. Southwest's swaps and other interest rate transactions should not exceed its outstanding floating interest rate long-term debt securities, or 20% of its total long-term debt outstanding (including future long-term debt which is the subject of a hedging arrangement), whichever is greater.

Southwest is placed on notice by this decision that the Commission may review the reasonableness of the effective interest rates for swaps, interest rate cap, floor or collar agreements issued by Southwest in conjunction with Southwest's general rate case or other ratemaking proceedings.

### **Competitive Bidding Rule**

The Competitive Bidding Rule applies only to utilities with bond ratings of "A" or higher (item 6 of Resolution No. F-616). Southwest's debt rating is "BBB-" as reported in the August 2001 C.A. Turner Utility Report and "Baa2" in the March 2001 Moody's Bond Rating. Accordingly, Southwest is exempted from the Competitive Bidding Rule in connection with this authorization.

### **Construction Budget**

Southwest's forecasted construction expenditures for calendar years 2001 through 2003 are as follows:

Components	(Thousands of Dollars)		
	<u>2001</u>	<u>2002</u>	<u>2003</u>
Gas Distribution Plant	\$174,700	\$174,600	\$167,400
Transmission Plant	10,600	20,500	34,100
General and Other Plant	<u>42,500</u>	<u>35,000</u>	<u>34,900</u>
Total	<u>\$227,800</u>	<u>\$230,100</u>	<u>\$236,400</u>

Southwest's construction expenditures total \$694,300,000 for 2001 through 2003.

**Cash Requirements Forecast**

Southwest's Statement of Cash Requirements for 2001 through 2003 are as follows:

(Thousand of Dollars)

Uses of Funds	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>Total</u>
Funds Used or Required for Construction Expenditures	\$227,800	\$230,100	\$236,400	\$ 694,300
Maturities/Refinancings:				
Redemption of Preferred Securities	-	-	-	-
Long-Term Debt	-	580,000	-	580,000
Short-Term Debt at Beg. Of Year to be Refinanced	<u>131,000</u>	<u>47,000</u>	<u>56,800</u>	<u>234,800</u>
Total	\$358,800	\$857,100	\$293,200	\$1,509,100
Less: Estimated Cash Available from Internal Sources	<u>96,000</u>	<u>209,300</u>	<u>138,200</u>	<u>443,500</u>
Additional New Funds Required from Outside Sources	<u>\$262,800</u>	<u>\$647,800</u>	<u>\$155,000</u>	<u>\$1,065,600</u>

Southwest's Statement of Cash Requirements indicates that it would require additional funds from external sources amounting to \$1,065,600 for 2001 through 2003.

**Capital Ratios**

Southwest's capital ratios as of March 31, 2001, are shown below as recorded and as adjusted to give pro forma effect to the transactions listed :

(Thousands of Dollars)

	<u>Recorded</u>		<u>Adjustments</u>	<u>Pro Forma</u>	
Common Equity	\$ 563,682	33.8	\$ 259,836 (a)	\$ 823,518	37.3
Preferred and Preference Equity	60,000	3.6	180,000 (b)	240,000	10.9
Short-Term Debt	-	-	-	-	-
Long-Term Debt	<u>1,041,908</u>	<u>62.6</u>	<u>100,000 (c)</u>	<u>1,141,908</u>	<u>51.8</u>
Total	<u>\$1,665,590</u>	<u>100.0</u>	<u>\$ 539,836</u>	<u>\$2,205,426</u>	<u>100.0</u>

(a) 11,056,864 shares at an estimated average \$23.50/share which include the following:

- (1) 4,765,200 unused shares at an estimated \$23.50/share under authority granted in D.00-11-034.
- (2) 4,234,800 new shares at an estimated \$23.50/share under authority granted in D.00-09-009, as amended by D.00-09-053.
- (3) 2,056,864 shares reserved but unissued for Company benefit plans at an estimated \$23.50/share under authority granted in D.00-11-034 and D.00-11-035.

(b) \$180 million of preferred securities as follows:

- (1) \$100 million under the authority granted in D.00-11-034 and D.00-11-035.
- (2) \$80 million of preferred stock under the authority granted in D.00-09-009, as amended by D.00-09-053.

(c) \$100 million of debt authority as follows:

- (1) \$550 million of authority requested in the Application.
- (2) Less: \$450 million of authority anticipated to be utilized in refinancing which may not meet the "Evergreening Authority" guidelines.

- (3) \$130 million of existing long-term Industrial Development Revenue Bonds will be refinanced under the Commission's "Evergreening Authority" guidelines<sup>1</sup>.

Capital structures are normally subject to review in cost of capital or general rate case proceedings. We will not, therefore, make a finding in this decision of the reasonableness of the projected capital ratios for ratemaking purposes.

### **Use of Proceeds**

Southwest states in the Application that the proceeds from the issuance of debt will be used for the following purposes (i) acquire property; (ii) construct, complete, extend, or improve its facilities (iii) refund maturing debt and preferred securities; (iv) fund payments or redemption requirements of debt and preferred securities (including any premiums required in connection therewith); (v) retire (through defeasance or otherwise), refinance, or exchange existing preferred securities and short- and long-term debt (including any premiums required in connection therewith; or (vi) reimburse its treasury for monies expended for expansion and betterment of its facilities.

In Resolution (Res.) ALJ 176-3069 dated August, 23, 2001, the Commission preliminarily categorized this Application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. Given these developments, a public hearing is not necessary, and there is no need to alter the preliminary determinations made in Res. ALJ 176-3069.

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to PU Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

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<sup>1</sup> D.94-12-018 dated December 7, 1994 as extended by D.00-09-009 dated September 7, 2000, granted Southwest "Evergreening Authority" (for long-term debt securities, preferred stock, and common stock). Evergreening provides a utility pre-authorization to issue securities for the purpose of refinancing securities at maturity, upon mandatory redemption, upon repurchase for mandatory sinking fund requirements, or upon optional refinancing to reduce financing costs, without corresponding new issue amounts being charged against Commission authorizations for "new money" securities. Evergreening is not intended to facilitate changes in a utility's capital structure or in the nature of the underlying assets being financed, or to expand the permitted uses of proceeds under the PU Code. Debt may be replaced only with debt, preferred stock with preferred stock, and common stock with common stock.



**Findings of Fact**

1. Southwest, a California corporation, is a public utility subject to the jurisdiction of this Commission.
2. Southwest needs external funds for the purposes set forth in the Application.
3. The authorized issue of debt obligations is for proper purposes and is not adverse to the public interest.
4. The use of interest rate risk management contracts, interest rate swap agreements, and other rate management agreements in appropriate circumstances are not adverse to the public interest.
5. Limiting Southwest's swaps and other derivative financial instruments issued in connection with long-term debt to those involving counterparties having credit ratings equal to or better than Southwest's will keep counterparty risk within acceptable bounds.
6. Southwest's California operating revenues are 11.88% of its total operating revenues.
7. Notice of the filing of the Application appeared on the Commission's Daily Calendar of August 15, 2001. There is no known opposition to this Application, and the authority requested should be granted, subject to the conditions below.

**Conclusions of Law**

1. A public hearing is not necessary.
2. The Application should be granted to the extent set forth in the order, which follows.
3. The authorized financing transactions are for lawful purposes and the money, property, or labor to be obtained is required for these purposes. The proceeds may not be charged to operating expenses or income.
4. Southwest's swaps and other interest rate transactions should not exceed the outstanding amount of its floating-rate long-term debt or 20% of its total long-term debt outstanding (including future long-term debt which is the subject of a hedging arrangement), whichever is greater.
5. PU Code § 823(d) provides that no note payable at a period of not more than 12 months after the date of issuance of such note shall be refunded, in whole or in part, by any issue of stocks or stock certificates or other evidence of interest or ownership, or of bonds,

notes of any term or character, or any other evidence of indebtedness, without the consent of the Commission.

6. The Competitive bidding Rule applies only to utilities with bond ratings of “A” or higher.

7. Southwest has previously paid the fee of \$38,678 determined in accordance with PU Code § 1904(b) and in proportion to its California operating revenues.

8. The following order should be effective on the date of signature.

### **ORDER**

It is **ORDERED** that:

1. On or after the effective date of this order, Southwest Gas Corporation (Southwest), upon terms and conditions substantially consistent with those set forth or contemplated in Application 01-08-012 (Application), is authorized to issue and obtain debt capital in an aggregate amount not to exceed \$550,000,000, in addition to its existing authority, through the direct issuance of one or more types of indebtedness, including, without limitation, debentures, bonds, notes, bank loans, private placements, commercial paper programs, extendible commercial notes, bankers’ acceptances, and other short-term variable-rate instruments (debt securities) which are or may become available in the capital markets or indirectly through one or more governmental agencies.

2. Southwest may determine the precise amount and timing of each debt financing, the market in and method by which each is issued, the principal amounts and maturities and, if any, the terms of redemption, repurchase security, other security, subordination and conversion provisions, rights, warrants, and the other terms and provisions and the price and interest rate (which may be fixed, adjustable, variable, or set by auction, remarketing, or other rate setting procedures) of the borrowings and of any securities related thereto or issuable in connection therewith in the manner set forth in the Application.

3. Southwest may refinance, refund, or replace short-term debt securities by the issuance and sale of debt securities authorized in this order.

4. Southwest's outstanding swaps and other interest rate transactions shall not exceed the outstanding amount of its floating-rate long-term debt or 20% of its total long-term debt outstanding (including future long-term debt which is the subject of a hedging arrangement), whichever is greater.

5. Southwest shall limit its use of interest rate risk management contracts and other derivative financial instruments issued in connection with long-term debt to those involving counterparties having credit ratings equal to or better than Southwest's.

6. If Southwest elects to terminate an interest rate agreement before the original maturity or the other party terminates the agreement, all costs associated with the termination shall be subject to review in Southwest's next cost of capital proceeding.

7. Southwest shall separately report all interest income and expense arising from all interest rate transactions in all monthly and annual financial reports to the Commission.

8. The authority granted herein shall be effective until the financing authorization is fully utilized.

9. The Application is granted as set forth above.

10. A.01-08-012 is closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.

LORETTA M. LYNCH

President

HENRY M. DUQUE

JOSIAH L. NEEPER

RICHARD A. BILAS

CARL W. WOOD

Commissioners